TransAlta™

Annual 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) should be read in conjunction with the consolidated financial statements and Auditors' Report included in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). All amounts in the following discussion are in millions of Canadian dollars unless otherwise noted. This MD&A is current as of Feb. 17, 2005. Additional information respecting TransAlta Utilities Corporation (TransAlta Utilities or the corporation), including its annual information form, is available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements, including statements regarding the business and anticipated financial performance of TransAlta Utilities. In some cases, forward-looking statements can be identified by terms such as 'may', 'will', 'believe', 'expect', 'potential', 'enable', 'continue' or other comparable terminology. These statements are not guarantees of TransAlta Utilities' future performance and are subject to risks, uncertainties and other important factors that could cause the corporation's actual performance to be materially different from those projected. Some of the risks, uncertainties, and factors include, but are not limited to: legislative and regulatory developments that could affect revenues, costs, and the speed and degree of competition entering the market; global capital markets activity; timing and extent of changes in commodity prices, prevailing interest rates, currency exchange rates, inflation levels and general economic conditions where TransAlta Utilities operates; results of financing efforts; changes in counterparty risk; and the impact of accounting policies issued by Canadian standard setters. Given these uncertainties, the reader should not place undue reliance on these forward-looking statements. See additional discussion under Risk Factors and Risk Management in this MD&A.

OVERVIEW

TransAlta Utilities owns and operates coal and hydro generation plants in the province of Alberta with a total generating capacity of 3,985 megawatts (MW).

The corporation's Generation operations, which were previously regulated, are subject to long-term arrangements. Under the terms of an Alberta Power Purchase Arrangement (PPA), a single customer has the rights to the entire production of a plant or unit for the length of the PPA.

PPAs establish committed capacity and electrical energy generation requirements and availability targets to be achieved by each coal-fired plant, energy and ancillary services obligations for the hydroelectric plants, and the pricing formula at which capacity and power is supplied. The corporation bears the risk or retains the benefit of volume variances (except for those arising from events considered to be force majeure, in the case of the coal-fired plants), and any change in costs required to maintain and operate the facilities.

The corporation's hydroelectric facilities are not contracted on a facility-by-facility basis, rather facilities are aggregated in a single PPA which provides for energy and ancillary services obligations based on hourly targets. TransAlta Utilities meets these targeted amounts through physical delivery or third party purchases.

TransAlta Utilities measures capacity as net maximum capacity which is consistent with industry standards. Capacity figures represent capacity owned and in operation unless otherwise stated.

Some of the corporation's accounting policies require management to make estimates or assumptions that in some cases may relate to matters that are inherently uncertain. Critical accounting policies and estimates for TransAlta Utilities include: revenue recognition, valuation and useful life of property, plant and equipment (PP&E); asset retirement obligations; income taxes; and employee future benefits. See additional discussion under Critical Accounting Policies and Estimates in this MD&A.

STRATEGY AND KEY PERFORMANCE INDICATORS

The corporation's strategy is to deliver sustainable and increasing earnings and cash flow through operations of a diversified portfolio of power generating assets. To implement this strategy, TransAlta Utilities focuses on maintaining a strong balance sheet, minimizing costs, utilizing existing assets efficiently and carefully managing the risk profile.

Availability is a key driver of TransAlta Utilities' financial results as approximately 85 per cent of the corporation's revenues are derived from contracts with either production or availability components. In 2004, the corporation spent $109.8 million on planned maintenance (2003 - $98.1 million) and achieved fleet availability 86.5 per cent, consistent with 87.1 per cent in 2003.

Long-term arrangements minimize TransAlta Utilities' exposure to market price fluctuations and provide a stable stream of revenues to support fixed operating costs, pay interest and fund capital expenditures. In 2004, 89 per cent of the corporation's production was sold under PPAs.

TransAlta Energy Marketing Corporation (TEM), an affiliate of the corporation, acts to maximize margins from the production and sale of electricity and reduce the risk to the corporation from unplanned outages by acquiring replacement power at the lowest possible price on behalf of TransAlta Utilities.

TransAlta Utilities is focused on maintaining a strong balance sheet and investment grade credit ratings. At Dec. 31, 2004, TransAlta Utilities debt to invested capital ratio was 27 per cent (2003 - 23 per cent). Debt to invested capital is defined on page 9 of this MD&A.

For TransAlta Utilities, key performance indicators include availability, production, fuel and operating costs and pricing applicable to non-contracted production. These are discussed in Operating Results in this MD&A. Other key performance indicators include the debt to invested capital ratio and credit ratings, which are discussed in Liquidity and Capital Resources.

HIGHLIGHTS

	2004	2003[1]	2002[1]
Availability	**86.5%**	87.1%	87.8%
Production (GWh)	**25,689**	27,002	30,024
	Amount	Amount	Amount
Revenues	**$ 744.8**	$ 731.5	$ 747.1
Fuel expense	**(209.7)**	(186.4)	(188.8)
Gross Margin	**$ 535.1**	$ 545.1	$ 558.3
Earnings from continuing operations	**$ 167.2**	$ 136.0	$ 37.7
Gain on disposal of discontinued operations	**6.8**	–	(2.8)
Net earnings	**$ 174.0**	$ 136.0	$ 34.9
Earnings per share from continuing operations	**$ 1.24**	$ 1.01	$ 0.27
Net earnings per common share	**$ 1.29**	$ 1.01	$ 0.25
Cash flow from operating activities	**$ 264.8**	$ 266.4	$ 250.2
Total assets	**$ 3,888.8**	$ 3,563.6	$ 3,632.5
Total long-term financial liabilities	**$ 2,315.0**	$ 2,402.8	$ 1,804.9
Cash dividends declared per common share	**$ –**	$ 700.0	$ 390.8

1 *TransAlta Utilities early adopted the amended standard for the presentation of liabilities and equity on Jan. 1, 2004. See* Note 1 *to the audited financial statements or the New Accounting Standards section of this MD&A for further discussion. Prior periods have been restated.*

SIGNIFICANT EVENTS

These consolidated financial results include the following significant events. All gains and losses discussed in this section are presented as pre-tax (after-tax) amounts.

2004

Finalization of Distribution and Retail operations sale

Effective Aug. 31, 2000, TransAlta Utilities sold its Distribution and Retail (D&R) operations, with a book value of $621.0 million to TransAlta Energy Corporation (TEC), an affiliate of the corporation, in exchange for $855.1 million of preferred shares of TEC which were redeemed on Sept. 29, 2000. The sale of the D&R operations from the corporation to TEC constituted a related party transaction because the corporation and TEC are under common ownership. Therefore, no gain on disposal was recorded and the $234.1 million excess of the proceeds received from TEC over the net book value of the D&R operations was recorded as contributed surplus. In 2000, pursuant to a Board of Directors' resolution, the contributed surplus was reclassified to retained earnings. In 2004, a regulatory decision relating to recovery of certain costs was issued that allowed the corporation to finalize outstanding items relating to the sale of the D&R operations. As a result, $10.2 million of unused provision against closing costs has been released to income as a gain on disposal of discontinued operations ($6.8 million). In addition, the redemption value of the preferred shares has been reduced by $10.2 million which, pursuant to the resolution of the Board of Directors, has been recorded as a charge to retained earnings. These adjustments were not made prior to 2004 as the corporation was awaiting a regulatory decision in order to finalize the purchase price.

Finalization of Transmission operations sale

TransAlta Utilities sold its Transmission operations, with a book value of $632.8 million, to TEC on April 22, 2002. In exchange, TransAlta Utilities received preferred shares of TEC that were redeemable for $818.2 million. The sale of the Transmission operations to TEC constituted a related party transaction and therefore no gain on disposal was recorded. These preferred shares were redeemed on May 31, 2002 and the difference between the book value of the Transmission operations and the preferred shares was recorded as an adjustment to contributed surplus. In 2002, pursuant to a Board of Directors' resolution, the contributed surplus was reclassified to retained earnings. In June 2004, a settlement was reached to finalize the sale of the Transmission operations which resulted in an adjustment to the redemption value of the preferred shares of $2.1 million. The $2.1 million increased the redemption value of the preferred shares to $820.3 million and pursuant to a resolution of the Board of Directors, the adjustment has been charged to retained earnings.

Preferred share investment

In June 2004, TransAlta Utilities acquired a US$255.2 million (Cdn$312.7 million at Dec. 31, 2004) preferred share investment in TEC using funds from a loan from TransAlta Corporation (TAC), the corporation's parent. The preferred shares bear a dividend rate of 5.8 per cent per annum and are redeemable at the option of the holder or issuer.

Wabamun plant

On Dec. 31, 2004, TransAlta Utilities decommissioned units one and two of the Wabamun plant (62 MW and 57 MW, respectively). The corporation plans to retire unit four (279 MW) in 2010 when its operating license expires. The PPA for the plant expired on Dec. 31, 2003 and production is now sold on the spot market.

2003

Sale of head office building

On May 9, 2003, TransAlta Utilities sold the Calgary head office building to an unrelated party for an agreed value of $65.8 million. TAC is leasing the property for a term of 20 years.

Sale of the Sheerness Generating Station

On July 18, 2003, the corporation sold its 50 per cent interest in the Sheerness Generating Station with a net book value of $435.8 million, to TEC in exchange for 6.75 per cent cumulative redeemable preferred shares with a face value of $630.0 million, which approximates fair value of the plant. As the sale of this plant from the corporation to TEC constituted a related party transaction, no gain on disposal was recorded, and the $213.0 million excess of proceeds received by the corporation over the net book value of the Sheerness Generating Station was recorded as contributed surplus. The corporation transferred $3.7 million of asset retirement obligation and $15.1 million of working capital and future income tax liability to TEC as part of this transaction.

Reduction in stated capital

Effective Dec. 31, 2003, pursuant to a resolution of the Board of Directors, the corporation reduced its stated capital and created contributed surplus of $550.0 million. The $550.0 million of contributed surplus was then reclassified to retained earnings and the corporation declared a cash dividend of $700.0 million to TAC.

Preferred securities offering

On Dec. 31, 2003, the corporation issued preferred securities to TAC for proceeds of $700.0 million. These are subordinated, unsecured and hold a dividend rate of 7.5 per cent.

Sale of Seebe land

On Dec. 31, 2003, TransAlta Utilities sold 539 acres of undeveloped land at Seebe, Alberta for $11.0 million. The corporation recognized a gain on sale of $10.5 million ($8.6 million).

OPERATING RESULTS

Availability for 2004 of 86.5 per cent was comparable to 87.1 per cent in 2003 .

Production decreased in 2004 by 1,313 gigawatt-hours (GWh) to 25,689 GWh compared to 2003 as a result of the sale of the Sheerness Generating Station in July 2003, partially offset by lower planned maintenance at the Alberta Thermal plants and an increase in hydro production in the second half of the year due to increased water availability.

Operating results were as follows:

	2004	2003
Revenues	**$ 744.8**	$ 731.5
Fuel expense	**(209.7)**	(186.4)
Gross margin	**535.1**	545.1
Operations, maintenance and administration	**220.8**	228.4
Depreciation and amortization	**80.0**	91.2
Taxes, other than income taxes	**7.4**	8.9
Loss (gain) on land sale	**2.1**	(10.5)
Operating income[1]	**$ 224.8**	$ 227.1

[1] *Operating income is not defined under GAAP. Refer to the Non-GAAP Measures section of this MD&A for a further discussion of operating income, including a reconciliation to net earnings.*

Revenues increased by $13.3 million for the year ended Dec. 31, 2004 compared to the same period in 2003. This increase was due to a decrease in the penalties related to planned maintenance at the Alberta Thermal plants ($37.3 million) and higher pricing obtained by the merchant Wabamun plant ($74.4 million). These increases were partially offset by a decrease in revenues of $70.5 million due to the sale of the Sheerness Generating Station and increased unplanned outages at the Alberta Thermal plants ($31.2 million).

Since the sale of the Sheerness Generating Station in the third quarter of 2003, all coal used for production under the PPAs is from coal reserves owned by TransAlta Utilities. Fuel costs also include variable transmission costs associated with the transmission of electricity. Fuel costs for the year ended Dec. 31, 2004 increased by $23.3 million compared to the same period of 2003. This reflects higher transmission costs associated with the merchant Wabamun plant ($22.0 million) and an increase in the cost of coal for Alberta Thermal plants resulting from higher diesel prices and increased overburden removal costs ($6.1 million). These increases were partially offset by a decrease in production costs resulting from the sale of the Sheerness Generating Station ($16.1 million). Transmission costs associated with electricity sales from the Wabamun plant were previously recovered under a PPA that expired on Dec. 31, 2003.

Operations, maintenance and administration expense (OM&A) for 2004 decreased by $7.6 million to $220.8 million as a result of decreased planned maintenance ($16.4 million) and the sale of the Sheerness Generating Station in the third quarter of 2003 ($9.3 million), partially offset by higher routine maintenance at the Alberta Thermal plants ($5.3 million) and higher inter-company management fees ($7.9 million).

Depreciation and amortization expense in 2004 decreased by $11.2 million to $80.0 million as a result of the sale of the Sheerness Generating Station ($9.9 million) with the remainder due to the sale of the head office building in the second quarter of 2003.

Taxes other than income taxes for the year ended Dec. 31, 2004 remained consistent with 2003.

INTEREST INCOME

	2004	2003
Interest income - preferred share investment in TEC	$ **131.4**	$ 79.0
Other interest income	**20.1**	16.0
Total interest income	$ **151.5**	$ 95.0

Interest income from preferred shares represents dividends earned on the corporation's preferred share investment in TEC. In 2004, interest income on preferred shares increased by $52.4 million as compared to 2003. This increase was primarily the result of the dividends declared on the $630.0 million investment received as proceeds on the sale of the Sheerness Generating Station in 2003. No dividends were declared in 2003 on this additional investment.

Other interest income from advances to TAC for 2004 is consistent with 2003.

INTEREST EXPENSE

	2004	2003
Interest expense - preferred securities	$ **138.6**	$ 86.2
Interest on long-term debt	**56.3**	73.1
Total interest expense	$ **194.9**	$ 159.3

During 2004 total interest expense, including preferred securities distributions, increased by $35.6 million over 2003.

Interest expense on preferred securities for 2004 increased by $52.4 million over 2003. This increase was the result of the $700.0 million preferred securities issued to TAC in December 2003, which bear an interest rate of 7.5 per cent per annum.

Interest expense on long-term debt for 2004 decreased by $16.8 million from 2003. This decrease in 2004 resulted from the maturity of $350.0 million of senior secured debentures in December 2003 and the maturity of the $100.0 million debentures with TAC in October of 2004, partially offset by increased interest paid to TAC related to a loan agreement entered into in June 2004, whereby TAC agreed to loan the corporation up to US$256.0 million.

INCOME TAXES

	2004	2003
Earnings before income taxes	**$ 191.6**	$ 162.3
Interest income - preferred share investment in TEC	**(131.4)**	(79.0)
Taxable earnings	**$ 60.2**	$ 83.3
Income taxes	**$ 17.6**	$ 26.3
Effective income tax rate	**29.2%**	31.6%

The corporation receives dividend income from TEC which is included in interest income but is not subject to income taxes under Canadian income tax regulations.

Income tax expense decreased by $8.7 million in 2004 over 2003 primarily as the result of lower taxable earnings and lower corporate income tax rates. The effective income tax rate (expressed as a percentage of earnings from continuing operations before income taxes) decreased to 29.2 per cent in 2004 compared to 31.6 per cent in 2003 due to the benefit of the reduced Alberta corporate income tax rate applied to TransAlta Utilities' future tax liabilities.

NEW ACCOUNTING STANDARDS

The Canadian Institute of Chartered Accountants has amended the standard on the presentation of liabilities and equity effective for years beginning on or after Nov. 1, 2004. The standard addresses the situation in which an entity has a contractual obligation of a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments, but the entity must, or can, settle the obligation by delivery of its own equity instruments (the number of which depends on the amount of the obligation). Such an obligation is a financial liability of the entity. TransAlta Utilities early adopted this standard effective Jan. 1, 2004 and has therefore presented the corporation's preferred securities as financial liabilities on the balance sheet. Preferred securities distributions are included in interest expense on the statement of earnings and are therefore included as a deduction in arriving at net earnings. Prior periods have been restated and as a result, preferred securities distributions, net of tax, have been reduced to nil in 2004 and 2003. Net interest expense for the year ended Dec. 31, 2004 was increased by $138.6 million (2003 - $83.9 million), and income tax expense for the year ended Dec. 31, 2004 was decreased by $46.9 million (2003 - $30.9 million). Preferred securities have been increased to $1,800.0 million from $1,749.8 million as at Dec. 31, 2003 with a corresponding decrease in long-term debt.

On Jan.1, 2004, TransAlta Utilities changed its accounting policy on the presentation of its preferred share investment in TEC. When a preferred share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument is a financial liability of the issuer and hence a financial asset of the holder. The preferred shares are disclosed as a long-term receivable from TEC on the balance sheet, and dividends earned on the preferred shares are disclosed as interest income on the statement of earnings. Prior periods have been restated to reflect this change. The Dec. 31, 2003 income statement has been restated to present $79.0 million of dividend income as interest income. This restatement resulted in no change to net earnings.

In March 2004, the U.S. Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-02, "Whether Mineral Rights are Tangible or Intangible Assets," that mineral rights, as defined in the Issue, are tangible assets. As a result of this decision, TransAlta Utilities accounts for coal rights under Canadian GAAP as tangible assets. Prior period amounts of $58.8 million at Dec. 31, 2003 have been reclassified from intangible assets to tangible assets. There was no effect on net earnings as a result of the reclassification.

OUTLOOK

The key factors affecting the financial results in 2005 are the megawatt capacity in place, the availability of and production from generating assets, the costs of production and the margins applicable to non-contracted production.

The following factors will be influenced by, but not limited to, certain risks and uncertainties. For further discussion, see Risk Factors and Risk Management in this MD&A.

Production and availability

In 2005, production is expected to decrease due to the decommissioning of units one and two (62 MW and 57 MW, respectively) of the Wabamun plant in the fourth quarter of 2004. Availability for 2005 is expected to be consistent with 2004.

Power prices

The PPA for the Wabamun plant expired on Dec. 31, 2003 and production is now sold on the spot market. Electricity spot prices in 2005 are expected to be slightly lower than in 2004 for the Alberta market. Downward pressure from the addition of new capacity is only partially offset by the expectation for stronger gas prices. Exposure to volatility in electricity prices is substantially mitigated through the remaining PPAs, as the majority of the production is contracted through capacity payments.

Costs of production

Fluctuations in the cost of coal are minimized through ownership of reserves in Alberta. OM&A costs fluctuate by quarter and are dependent on the timing and nature of maintenance activities. OM&A costs in 2005 are expected to be slightly lower than 2004 as a result of the decommissioning of units one and two of the Wabamun plant.

Cash requirements

In 2005, cash will be provided by a combination of cash flow from operations and utilization of credit facilities. Capital expenditures for 2005 are expected to be approximately $110 to $115 million (approximately half of this amount is for capital expenditures related to planned maintenance).

Net interest expense and dividend income

Net interest expense is expected to decrease in 2005 as a result of the maturity of the $100.0 million debenture with TAC in October 2004.

Income tax expense

The corporation anticipates incurring tax charges for the year based on current and forecasted results. However, the tax charge will be significantly lower than prior years primarily due to lower taxable income as a result of higher non-taxable dividends from TEC.

Climate change

On Dec. 16, 2002, the Canadian government ratified the Kyoto Protocol, which came into effect on Feb. 16, 2005. TransAlta Utilities is not able to estimate the full impact the Protocol will have on its operations, as the Canadian government has not yet established the regulatory requirements. However, the PPAs for TransAlta Utilities' coal-fired plants contain 'Change of Law' provisions that should provide an opportunity to recover compliance costs from the PPA customers.

CONSOLIDATED BALANCE SHEETS

The following chart outlines significant changes in the consolidated balance sheets between Dec. 31, 2004 and Dec. 31, 2003:

	Increase/ (Decrease)	Explanation
Cash	$ (8.5)	Refer to Statement of Cash Flows.
Loan receivable from TAC	74.2	Advances made to TAC.
Interest receivable from TEC	48.5	Accrual of interest receivable from TEC on $630.0 million of preferred shares.
Income taxes receivable	(48.7)	Funding for settlement with taxation authorities on prior year audit issues (finalization of D&R sale) and refunds of tax prepayments made in prior years.
Property, plant and equipment, net	(33.8)	Depreciation and amortization expense partially offset by capital expenditures at the hydro and thermal plants.
Long-term receivable from TEC	312.7	Purchase of preferred shares in TEC in the amount of US$255.2 million.
Short-term debt	314.5	The receipt of a demand loan from TAC of US$256.0 million.
Long-term debt (including current portion)	(105.8)	Long-term debt has decreased primarily due to the maturity of the $100.0 million debenture with TAC.
Asset retirement obligations	(16.0)	Decrease in asset retirement obligations is due to revisions in estimated cash flows, partially offset by accretion of asset retirement obligations.
Future income tax liabilities	(38.0)	Finalization of the sale of the D&R operations.
Common shareholder's equity	165.9	Net earnings for the period and the final settlement adjustments on the sale of the D&R and Transmission operations.

LIQUIDITY AND CAPITAL RESOURCES

	2004	2003	Explanation
Cash, beginning of period	**$ 8.5**	$ 8.0	
Cash provided by (used in):			
Operating activities	**264.8**	266.4	In 2004, cash inflows were generated from cash earnings, a gain on the finalization of the D&R sale, and improved working capital balances. In 2003, cash inflows were generated from cash earnings and improved working capital balances.
Investing activities	**(471.6)**	86.1	In 2004, cash outflows resulted from the purchase of preferred shares in TEC for US$255.2 million, advances made to TAC of $74.2 million and capital expenditures primarily related to maintenance of $86.8 million. In 2003, cash inflows resulted from a decrease in the demand loan to TAC of $86.2 million and sale proceeds of $76.8 million from the head office building and Seebe land, partially offset by capital expenditures of $76.0 million.
Financing activities	**198.3**	(352.0)	The cash inflow in 2004 primarily resulted from issuance of the demand loan to TAC, partially offset by repayment of the $100.0 million debenture with TAC. The cash outflow in 2003 primarily resulted from the repayment of the $350.0 million senior secured debentures.
Cash, end of period	**$ –**	$ 8.5	

In 2004, TransAlta Utilities primarily used cash flow from operations to advance $74.2 million to TAC, for $86.8 million of capital expenditures and for repayment of the $100.0 million debenture with TAC. In 2003, cash flow from operations, proceeds from the sale of the head office building and Seebe land and a decrease in the demand loan with TAC was used primarily for $76.0 million of capital expenditures and repayment of $350.0 million of senior secured debentures. The net increase in short-term debt in 2004 was $314.5 million while there was no short-term debt in 2003.

Details on the senior secured debt repaid in 2004 discussed above are as follows:

	Maturity	Rate	Amount repaid
Debentures	2004	6.3%	$ 100.0

Repayment of the senior secured debt was funded from cash flow from operations.

FINANCING ARRANGEMENTS

In 2005, cash is expected to be provided by a combination of cash flow from operations and utilization of available credit facilities. Cash requirements include maintenance, additions to capital assets and repayment of short-term and maturing senior debt.

TransAlta Utilities has a $50.0 million non-committed bank credit facility that can be used for general operating and capital purposes as well as for the issuance for letters of credit. At Dec. 31, 2004, $49.7 million was utilized for the issuance of letters of credit (2003 - $50.0 million).

At Dec. 31, 2004, TransAlta Utilities had a working capital ratio of 103 per cent compared to 215 per cent at Dec. 31, 2003. The corporation expects to have sufficient sources of internal and external capital to finance operations and growth in the short and long-term.

DEBT STRUCTURE

Capital for TransAlta Utilities is raised by TAC. At Dec. 31, 2004, borrowings were comprised of the following:

	Outstanding	Interest rate[1]	Maturity
Preferred securities	$1,800.0	7.7%	2050 and 2052
Debentures	598.4	6.5%	2005 - 2033
Capital lease obligations	0.8	8.0%	2005
Total	$ 2,399.2		

1 *Interest is an average rate weighted by principal amounts outstanding.*

The debentures include $150.0 million held by TAC. The remainder of the debentures are directly issued to the capital markets. The preferred securities balance represents $1.1 billion and $700.0 million due in 2050 and 2052, respectively.

The corporation's target is to maintain a capital structure and coverage ratios consistent with investment grade credit ratings. The corporation's capital structure consisted of the following components at Dec. 31, 2004 and 2003:

		2004		2003
Debt, net of cash	**$ 913.7**	**27%**	$ 696.5	23%
Preferred securities	**1,800.0**	**53%**	1,800.0	59%
Common shareholders' equity	**699.7**	**20%**	533.8	18%
	$ 3,413.4	**100%**	$ 3,030.3	100%

At Dec. 31, 2004, TransAlta Utilities' total debt to invested capital ratio was 27 per cent as compared to 23 per cent at Dec. 31, 2003. Debt to invested capital is defined as net debt, divided by net debt plus preferred securities plus common shareholders' equity. Net debt is defined as short-term debt plus long-term debt less cash.

Additional key financial ratios were as follows:

	2004	2003
Cash flow to interest[1]	**6.9x**	4.0x
Cash flow to total debt[2]	**31%**	22%

1 *Cash flow from operations before changes in working capital plus interest expense less interest income divided by interest expense less interest income.*
2 *Cash flow from operations before changes in working capital divided by two-year average of total debt (excluding preferred securities).*

Contractual repayments of long-term debt, commitments under operating leases and commitments under mining agreements are as follows:

	2005	2006	2007	2008	2009	2010 and thereafter	Total
Long-term debt	$ 84.2	$ 100.0	$ –	$ 115.0	$ 150.0	$ 1,950.0	$ 2,399.2
Operating leases	4.1	3.3	2.1	1.1	0.6	0.2	11.4
Mining agreements	8.6	8.2	8.3	4.8	4.9	67.4	102.2
Total contractual cash obligations	$ 96.9	$ 111.5	$ 10.4	$ 120.9	$ 155.5	$ 2,017.6	$ 2,512.8

In the normal course of operations, TransAlta Utilities enters into agreements to provide financial or performance assurances to third parties. This includes guarantees, letters of credit and surety bonds which are entered into to support or enhance creditworthiness in order to facilitate the extension of sufficient credit for construction projects and equipment purchases.

At Dec. 31, 2004, the corporation had $59.8 million in letters of credit outstanding. All letters of credit expire in 2005. No guarantees or surety bonds were outstanding at Dec. 31, 2004.

Credit ratings

	S&P	DBRS
Issuer rating	BBB-	
Secured debt	BBB	A (low)

In January 2005, Dominion Bond Rating Service (DBRS) confirmed a rating of A (low) to the corporation's secured debentures. In December 2004, Standard and Poor's (S&P) confirmed a credit rating of BBB- (stable).

On Feb. 17, 2005, TransAlta Utilities had 135.0 million common shares outstanding in the amount of $250.9 million.

OFF-BALANCE SHEET ARRANGEMENTS

Disclosure is required of all off-balance sheet arrangements such as transactions, agreements or contractual arrangements with unconsolidated entities, structured finance entities, special purpose entities or variable interest entities that are reasonably likely to materially affect liquidity or the availability of, or requirements for, capital resources. The corporation has no such off-balance sheet arrangements.

In compliance with GAAP, derivatives used in hedging relationships are not recorded on the balance sheet. Gains or losses during the term of the hedge are deferred and recognized in earnings in the same period and financial statement caption as the hedged exposure (settlement accounting). The corporation also enters into long-term electricity sale and transportation agreements in the normal course of operations. These contracts are not recorded on the balance sheet as is in accordance with GAAP.

RELATED PARTY TRANSACTIONS

As discussed in Significant Events, in June 2004, TransAlta Utilities acquired a US$255.2 million preferred share investment in TEC using funds from a loan from TAC. The preferred shares bear a dividend rate of 5.8 per cent per annum and are redeemable at the option of the holder or issuer.

The corporation sold its interest in the Sheerness Generating Station to TEC on July 18, 2003 at a net book value of $435.8 million in exchange for preferred shares in TEC with a face value of $630.0 million, which approximates the fair value of the plant. The exchange amount was determined based on an estimate of the future net cash flows of the plant. The cumulative preferred shares hold a dividend rate of 6.75 per cent payable quarterly, and interest accrues and compounds on any unpaid dividends at a rate of 10.4 per cent per annum. These shares are redeemable at the option of the corporation. As the sale of this plant from the corporation to TEC constituted a related party transaction, no gain on disposal was recorded, and the $213.0 million excess of proceeds received by the corporation over the net book value of the Sheerness Generating Station was recorded as contributed surplus.

On Dec. 31, 2003, the corporation issued preferred securities to TAC for proceeds of $700.0 million. These are subordinated, unsecured and hold a dividend rate of 7.5 per cent.

During the year, the corporation engaged in related party transactions with TAC and TEC. These transactions were recorded at their exchange amounts and settled under commercial terms. The exchange amounts are estimated based on rates and terms which would have been used for similar transactions with third parties or the amounts approximate cost.

RISK FACTORS AND RISK MANAGEMENT

TransAlta Utilities uses a multi-level risk management oversight structure to manage the corporation's various risks and exposures.

The Audit and Environment (A&E) Committee provides assistance to the Board of Directors in fulfilling its oversight responsibility relating to the integrity of the corporation's financial statements and the financial reporting process; the systems of internal accounting and financial controls; the internal audit function; the external auditors' qualifications, independence, performance and reports and the legal and environmental compliance programs as established by management and the Board of Directors.

The Exposure Management (EM) Committee is chaired by the Chief Financial Officer and is comprised of the Directors of Financial Operations for each business unit, the Executive Vice-President of Commercial Development and Marketing, Vice-President and Treasurer, Vice-President and Comptroller and the Director of Risk Management. The EM Committee is responsible for the review, monitoring and reporting on compliance of these financial and commodity risk exposure management policies.

The following addresses some, but not all, risk factors that could affect TransAlta Utilities' future results. A discussion of critical estimates made in the application of accounting policies is provided in the Critical Accounting Policies and Estimates section that follows.

COMMODITY PRICE RISK The corporation has exposure to movements in commodity prices, including the market price of electricity and the coal used to produce electricity. Coal used in electricity generation is from coal reserves owned by TransAlta Utilities, thereby limiting the corporation's exposure to fluctuations in the market price of coal.

The corporation's coal-fired and hydro electric facilities operate under the PPAs which, among other things, establish the price at which power will be supplied. In addition to the PPAs, the corporation has entered into a variety of short- and long-term contracts to minimize its exposure to short-term fluctuations in electricity prices. In the event of a planned or unplanned plant outage or other similar event, however, the corporation is exposed to changes in electricity prices on purchases of electricity from the market to fulfill its supply obligations under these short- and long-term contracts. The corporation actively seeks to mitigate this exposure through continued and proper maintenance of its electricity generating plants, force majeure clauses negotiated in its contracts, trading activities and insurance.

In 2005, electricity generation from the Wabamun plant will be exposed to price fluctuations of electricity sold to the market, however, 91 per cent of total output will remain fixed at contractual prices. In 2004, 89 per cent (2003 - 99 per cent) of total output was at contractually fixed prices.

FOREIGN CURRENCY EXPOSURE The corporation may have exposures to various currencies as a result of its acquisition of equipment and services from foreign suppliers. These exposures are hedged through the use of foreign currency forward purchase contracts.

CREDIT RISK If the counterparties to the corporation's contracts are unable to meet their obligations, the corporation's revenues could be adversely affected. The corporation actively manages its exposure to credit risk by assessing the ability of counterparties to fulfill their obligations under the related contracts prior to entering into such contracts. TransAlta Utilities is exposed to minimal credit risk for PPAs because under the terms of these arrangements all receivables are secured by letters of credit.

INTEREST RATE EXPOSURE The corporation has exposure to declines in short-term interest rates from having issued floating rate debt to TAC. At Dec. 31, 2004, floating rate loans were extended in the amount of approximately 11 per cent of the corporation's total fixed rate debt portfolio. The corporation is also exposed to declines in long-term interest rates, as PPA revenue is in part indexed to the yield on long-term Government of Canada bonds.

HYDRO RISK The corporation's hydro operations financial performance is partially dependent upon the availability of water in a given year. The availability of water is difficult to forecast as it is driven by non-controllable factors, primarily weather, which impact the volume, timing and location of precipitation throughout the province of Alberta. Such water availability introduces a degree of volatility in revenues earned by the corporation's hydro operations from year to year. This risk is complicated by obligations imposed within the PPA applicable to the corporation's hydro plants. A monthly financial obligation must be paid to the PPA Buyer, based on a predetermined quantity of energy and ancillary services at market prices, regardless of the corporation's ability to generate such quantities. TransAlta Utilities manages these risks on a real-time basis by monitoring water resources throughout Alberta to the best of its ability, and optimizing this resource against real-time electricity market opportunities. The corporation also plays an important role in the management of water flows and levels in several key areas of Alberta including two major cities. TransAlta Utilities carefully balances all of these factors together to achieve optimal productivity with the water resources available.

OPERATIONAL RISK The corporation's plants have exposure to operational risks such as fatigue cracks in boilers, corrosion in boiler tubing, turbine failures and other issues that can lead to outages. A comprehensive plant maintenance program and regular turnarounds reduce this exposure. If the plants do not meet the availability or production targets specified in the PPAs then the corporation must compensate the purchaser for the loss in the availability of production. Consequently, an extended outage could have a material adverse effect on the business, financial condition, results of operations, or cash flows of the corporation. Insurance and force majeure clauses in the PPAs further mitigate this exposure.

Approximately 70 per cent of the corporation's labour force is covered under collective bargaining agreements. The corporation is currently a party to two different collective bargaining agreements one of which was recently renegotiated, and it anticipates settling the other agreement in 2005.

The construction and development of generating facilities and acquisition activities are subject to various environmental, engineering and construction risks relating to cost-overruns, delays and performance. The corporation attempts to minimize these risks by performing detailed analysis of project economics prior to construction or acquisition and by securing favourable power sales agreements.

ENVIRONMENTAL, HEALTH AND SAFETY RISK The corporation's operations are subject to extensive federal, provincial, state and local environmental regulation. If the corporation does not comply with environmental requirements, regulatory agencies could seek to impose civil, administrative, or criminal liabilities on the corporation, as well as seek to curtail its operations. TransAlta Utilities' approach is to continually improve the management of operational risks in the areas of environment, health and safety while developing mechanisms to manage future risks. These programs are integrated into the operations and management systems of the corporation and are designed to mitigate the potential competitive risks to its fossil-fuelled generation plants from future changes in environmental policy.

TransAlta Utilities has implemented an ISO-based environmental, health and safety (EHS) management system, designed to continuously improve environmental and safety performance at all of its plants. Compliance with both regulatory requirements and management system standards is regularly audited through TransAlta Corporation's Performance Assurance policy and results are reported quarterly to the Board of Directors.

TransAlta Utilities is subject to federal, provincial and local environmental laws, regulations and guidelines concerning the generation and transmission of electrical and thermal energy and surface mining. TransAlta Utilities strives to maintain compliance with all environmental regulations relating to its operations and facilities. Quarterly reports on all EHS regulatory changes are provided to each facility to ensure compliance is maintained. TransAlta Utilities works with regulators in Canada to ensure regulatory changes are well-designed and cost-effective. If regulations were to change however, the operational and financial impact on all plants would need to be assessed. Outcomes may include, but are not limited to: increased compliance, maintenance or capital costs; plant impairment charges; or the decommissioning of certain facilities.

TransAlta Utilities' environment, health and safety policy requires that the impacts and risks of the corporation's activities are identified, assessed and managed. This is done by the use of an environmental management system to set environmental objectives and regularly review subsequent performance with senior management and mitigative action on longer-term environmental policy impacts such as climate change.

Emission reduction objectives for the power sector are being established by the Canadian government. While uncertainty still exists as to the ultimate form and specific detail of Canada's climate change regulations, TransAlta Utilities' climate change strategy addresses the potential competitive risks to its fossil-fuelled generation plants. That strategy includes the development of clean coal technology. The PPAs for TransAlta Utilities' coal-fired plants contain 'Change of Law' provisions that should provide an opportunity to recover compliance costs from the PPA customers.

REGULATORY AND POLITICAL RISK Regulatory and political risks exist in Alberta. The corporation is not able to predict whether there will be any changes in the regulatory environment or the ultimate effect of changes in the regulatory environment on its business. TransAlta Utilities manages these risks by working with regulators, governments, agencies, and other stakeholders to identify and attempt to resolve issues as fairly and expeditiously as possible. A wholesale market review task force and a retail market review were initiated in Alberta in 2004 to evaluate the functioning of the electricity market and consider market design changes. A market design policy recommendation is expected in 2005. TransAlta Utilities continues to work with the task force to ensure any regulatory changes are well-designed and cost-effective. If regulations were to change however, the operational and financial impact on all Alberta plants and trading operations would need to be assessed. Outcomes may include, but are not limited to: increased compliance, operating or capital costs; reduced operational flexibility; or reduced power prices and volatility.

TRANSMISSION RISK In August 2003, a blackout cut off electricity to millions of residents in the Northeastern U.S. and Eastern Canada. This type of event, although extremely unusual, is an ongoing risk for electric companies. This risk is mitigated through force majeure clauses in the PPAs and access to multiple transmission lines. Transmission constraints within Alberta limit opportunities for exports, generation additions and uprates at existing generating facilities. We manage this risk by intervening in and supporting applications for transmission upgrades and additional transmission construction. We also work closely with agencies and other stakeholders to identify and resolve transmission issues as they arise.

GENERAL ECONOMIC CONDITIONS Changes in general economic conditions impact product demand, revenue, operating costs, timing and extent of capital expenditures, the net recoverable value of property, plant and equipment, results of financing efforts, credit risk and counterparty risk.

INCOME TAXES The corporation's operations are complex, and the computation of the provision for income taxes involves tax interpretations, regulations and legislation that are continually changing. The corporation's tax filings are subject to audit by taxation authorities. Management believes that it has adequately provided for income taxes based on all information currently available.

LEGAL CONTINGENCIES The corporation is occasionally named as a defendant in various claims and legal actions. Exposure to these claims is mitigated through levels of insurance coverage considered appropriate by management and active management of these claims. Except as disclosed in *Note 18* to the consolidated financial statements, the corporation does not expect the outcome of the claims or potential claims to have a materially adverse effect on the corporation given the nature of the claims, the amounts in dispute or claimed and the availability of insurance.

OTHER CONTINGENCIES The corporation maintains a level of insurance coverage deemed appropriate by management. There were no significant changes to TransAlta Utilities' insurance coverage during 2004.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The selection and application of accounting policies is an important process that has developed as TransAlta Utilities' business activities have evolved and as accounting rules have changed. Accounting rules generally do not involve a selection among alternatives, but involve an implementation and interpretation of existing rules and the use of judgment relative to the circumstances existing in the corporation's business. Every effort is made to comply with all applicable rules on or before the effective date, and TransAlta Utilities believes the proper implementation and consistent application of accounting rules is critical. However, not all situations are specifically addressed in the accounting literature. In these cases, the corporation's best judgment is used to adopt a policy for accounting for these situations. This is accomplished by analogizing to similar situations and the accounting guidelines governing them, consideration of foreign accounting standards and consultation with the corporation's independent auditors about the appropriate interpretation and application of these policies. Each of the critical accounting policies involves complex situations and a high degree of judgment either in the application and interpretation of existing literature or in the development of estimates that impact the corporation's consolidated financial statements.

TransAlta Utilities' significant accounting policies are described in *Note 1* to the consolidated financial statements. The most critical of these policies are those related to property, plant and equipment, asset retirement obligations, income taxes and employee future benefits (*Notes 1 (C), (F), (G), (H) and (I)*, respectively). Each policy involves a number of estimates and assumptions to be made by management about matters that are highly uncertain at the time the estimate is made. Different estimates, with respect to key variables the corporation used for the calculations, or changes to estimates could potentially have a material impact on TransAlta Utilities' financial position or results of operations. These critical accounting estimates are described below.

Management has discussed the development and selection of these critical accounting estimates with the A&E Committee and the corporation's independent auditors. The A&E Committee has reviewed and approved the corporation's disclosure relating to critical accounting estimates in this MD&A.

Revenue Recognition

The majority of the corporation's revenues are derived from the production of power in Alberta. Revenues under Alberta PPAs generally include one or more of the following components: fixed capacity payments for being available; energy payments for generation of electricity; availability incentives or penalties for exceeding or not meeting availability targets; excess energy payments for power generation above committed capacity; and ancillary services. Each is recognized upon output, delivery, or satisfaction of specific targets, as specified by contractual terms. Revenues from non-contracted capacity are comprised of energy payments for each MWh produced at market prices, and are recognized upon delivery.

Valuation of property, plant and equipment

PP&E makes up 36 per cent of the corporation's assets. On an annual basis, and when indicators of impairment exist, TransAlta Utilities determines whether the net carrying amount of PP&E is recoverable from future undiscounted cash flows. Factors which could indicate that an impairment exists include significant underperformance relative to historical or projected operating results, significant changes in the manner or use of the assets, significant negative industry or economic trends, or a change in the strategy for the corporation's overall business. In some cases, these events are clear. However, in many cases, a clearly identifiable event indicating possible impairment does not occur. Instead, a series of individually insignificant events occur over a period of time leading to an indication that an asset may be impaired. As a result, events occurring in these situations may not be known until a date subsequent to their occurrence.

The corporation's businesses, the markets and business environment are continually monitored, and judgments and assessments are made to determine whether an event has occurred that indicates possible impairment. If such an event has occurred, an estimate is made of the future undiscounted cash flows from the asset. If the total of the undiscounted future cash flows, excluding financing charges, is less than the carrying amount of the asset, an asset impairment charge must be recognized in the financial statements. The amount of the impairment recognized is calculated by subtracting the fair value of the asset from the carrying value of the asset. Fair value is the amount at which an item could be bought or sold in a current transaction between willing parties, and is best estimated by calculating the net present value of future expected cash flows related to the asset. Both the identification of events that may trigger an impairment and the estimates of future cash flows and the fair value of the asset require considerable judgment.

The assessment of asset impairment requires management to make significant assumptions about future sales prices, cost of sales, production and fuel consumed over the life of the plants (up to 30 years), retirement costs and discount rates. In addition, when impairment tests are performed, the estimated useful lives of the plants are reassessed, with any change accounted for prospectively.

In estimating future cash flows of the plants, the corporation uses estimates of contracted and future market prices based on expected market supply and demand in the region in which the plant operates, anticipated production levels, planned and unplanned outages, and transmission capacity or constraints for the remaining life of the plant. Actual results can, and often do, differ from the estimates, and can have either a positive or negative impact on the estimate of the impairment charge, and may be material.

The results of TransAlta Utilities' annual impairment review showed no indications of impairment.

Asset retirement obligations

The corporation recognizes asset retirement obligations for PP&E in the period in which they are incurred if a reasonable estimate of a fair value can be determined. The fair value of the liability is described as the amount at which the liability could be settled in a current transaction between willing parties. Expected values are probability weighted to deal with the risks and uncertainties inherent in the timing and amount of settlement of many asset retirement obligations. Expected values are discounted at the risk-free interest rate adjusted to reflect the market's evaluation of the entity's credit standing. Determining asset retirement obligations requires estimating the life of the related asset and the costs of activities such as demolition, dismantling, restoration and remedial work based on present day methods and technologies.

At Dec. 31, 2004, the asset retirement obligations recorded on the consolidated balance sheet were $98.1 million. TransAlta Utilities estimates the undiscounted amount of cash flow required to settle the obligations is approximately $587.2 million, which will be incurred between 2005 and 2072. The majority of these costs will be incurred between 2020 and 2030.

Useful life of property, plant and equipment

PP&E is depreciated over its estimated useful life. Estimated useful lives were determined based on current facts and past experience, and take into consideration the anticipated physical life of the asset, existing long-term sales agreements and contracts, current and forecasted demand and the potential for technological obsolescence. Major components of plants are depreciated over their own useful lives. A component is a tangible asset that can be separately identified as an asset, and is expected to provide a benefit of greater than one year.

Depreciation and amortization expense was $100.9 million in 2004, of which $27.5 million relates to mining equipment, and is included in fuel expense.

The rates used are reviewed on an ongoing basis to ensure they continue to be appropriate, and are also reviewed in conjunction with impairment testing, as discussed above.

Income taxes

In accordance with GAAP, the corporation uses the liability method of accounting for future income taxes and provides future income taxes for all significant income tax temporary differences.

Preparation of the consolidated financial statements requires an estimate of income taxes in the jurisdictions in which the corporation operates. The process involves an estimate of the corporation's actual current tax exposure and an assessment of temporary differences resulting from differing treatment of items, such as depreciation and amortization, for tax and accounting purposes. These differences result in future tax assets and liabilities which are included in the corporation's consolidated balance sheet.

An assessment must also be made to determine the likelihood that the corporation's future tax assets will be recovered from future taxable income. To the extent that recovery is not considered likely, a valuation allowance must be determined. Judgment is required in determining the provision for income taxes, future income tax assets and liabilities and any related valuation allowance. To the extent a valuation allowance is created or revised, current period earnings will be affected.

Future tax assets of $9.0 million have been recorded on the consolidated balance sheet at Dec. 31, 2004. This relates primarily to employee benefit obligations. Future tax liabilities of $198.0 million have been recorded on the consolidated balance sheet at Dec. 31, 2004. The liability is comprised primarily of income tax deductions in excess of related depreciation of PP&E, partially offset by asset retirement obligation costs.

Judgment is required to assess tax interpretations, regulations and legislation, which are continually changing, to ensure liabilities are complete and to ensure assets, net of valuation allowances, are realizable. The impact of different interpretations and applications could potentially be material.

The corporation's tax filings are subject to audit by taxation authorities. The outcome of some audits may change the tax liability of the corporation, although management believes that it has adequately provided for income taxes based on all information currently available. The outcome of the audits is not known, nor is the potential impact on the financial statements determinable.

Employee future benefits

The corporation has a registered pension plan with defined benefit and defined contribution options and a supplemental defined benefit plan covering substantially all employees of the corporation. The defined benefit option of the registered pension plan ceased for new employees on June 30, 1998. The latest actuarial valuations of the registered and supplemental pension plans were as at Dec. 31, 2004. The supplemental pension plan is an obligation of the corporation. The corporation is not obligated to fund the supplemental plan but is obligated to pay benefits under the terms of the plan as they come due.

The corporation provides other health and dental benefits to the age of 65 for both disabled members (other post-employment benefits) and retired members (other post-retirement benefits). The latest actuarial valuation of these other plans was as at April 30, 2002.

The cost of providing these benefits is dependent upon many factors which result from actual plan experience and assumptions of future experience.

The liability for future benefits and associated pension costs included in annual compensation expenses are impacted by employee demographics, including age, compensation levels, employment periods, the level of contributions made to the plans and earnings on plan assets. Changes to the provisions of the plans may also affect current and future pension costs. Pension costs may also be significantly impacted by changes in key actuarial assumptions, including anticipated rates of return on plan assets and the discount rates used in determining the projected benefit obligation and pension costs.

The plan assets are comprised primarily of equity and fixed income investments. Fluctuations in actual equity market returns and changes in interest rates may result in increased or decreased pension costs in future periods.

The expected long-term rate of return on plan assets is based on past performance and economic forecasts for the types of investments held by the plan. For the year ended Dec. 31, 2004, the plan assets had a return of $29.4 million compared to a return of $31.5 million in 2003. The 2004 actuarial valuation used a rate of return on plan assets of 7.0 per cent (2003 - 7.0 per cent).

NON-GAAP MEASURES

TransAlta Utilities evaluates its performance using a variety of measures. Those discussed below are not defined under GAAP and therefore should not be considered in isolation or as an alternative to, or more meaningful than, net income or cash flow from operations as determined in accordance with GAAP as an indicator of the corporation's financial performance or liquidity. These measures are not necessarily comparable to a similarly titled measure of another company.

Operating income is a measure of financial performance used by TransAlta Utilities' analysts and investors to analyze and compare companies on the basis of operating performance.

Gross margin less operating expenses and operating income provide management with a measurement of operating performance which is readily comparable from period to period.

Gross margin less operating expenses and operating income are reconciled to net earnings below:

	2004	2003
Gross margin	**$ 535.1**	$ 545.1
Operating expenses	**310.3**	318.0
Operating income	**224.8**	227.1
Interest expense	**(194.9)**	(159.3)
Interest income	**151.5**	95.0
Foreign exchange loss	**–**	(0.5)
Earnings from continuing operations before income taxes	**181.4**	162.3
Income tax expense	**14.2**	26.3
Earnings from continuing operations	**167.2**	136.0
Gain on disposal of discontinued operations, net of tax	**6.8**	–
Net earnings	**$ 174.0**	$ 136.0

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q1 2004	Q2 2004	Q3 2004	Q4 2004
Revenues	**$ 193.3**	**$ 185.5**	**$ 172.6**	**$ 193.4**
Earnings from continuing operations	**57.1**	**42.5**	**25.2**	**42.4**
Net earnings	**57.1**	**42.5**	**32.0**	**42.4**
Earnings per common share from continuing operations, basic and diluted	**0.42**	**0.31**	**0.19**	**0.32**
Net earnings per common share, basic and diluted	**0.42**	**0.31**	**0.24**	**0.32**

	Q1 2003	Q2 2003	Q3 2003	Q4 2003
Revenues	$ 215.5	$ 204.6	$ 147.8	$ 163.6
Earnings from continuing operations	37.5	46.9	3.6	48.0
Net earnings	37.5	46.9	3.6	48.0
Earnings per common share from continuing operations, basic and diluted	0.28	0.35	0.03	0.35
Net earnings per common share, basic and diluted	0.28	0.35	0.03	0.35

TransAlta Utilities' results are partly seasonal due to the nature of the electricity market and related fuel costs. Higher maintenance costs are ordinarily incurred in the second and third quarters when electricity prices are expected to be lower as electricity prices generally increase in the winter months in the Canadian market. Margins are also typically impacted in the second quarter due to the volume of hydro production resulting from spring run-off and rainfall in the Canadian market. TransAlta Utilities' results reflect the disposition of plants and facilities throughout 2003 and 2004 as described previously within this MD&A.

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY

TransAlta Utilities' management is responsible for presentation and preparation of the annual consolidated financial statements, management's discussion and analysis (MD&A) and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

The MD&A has been prepared in accordance with the requirements of security regulators including National Instruments 44-101 and 51-102 of the Canadian Securities Administrators and their related published documents.

The consolidated financial statements and information in the MD&A necessarily include amounts based on informed judgments and estimates of the expected effects of current events and transactions with appropriate consideration for materiality. In addition, in preparing financial information, the corporation must interpret the requirements described above, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MD&A also includes information regarding the estimated impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because future events and circumstances may not occur as expected.

The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control which are designed to provide reasonable assurance that financial information is relevant, reliable and accurate, and that assets are safeguarded and transactions are executed in accordance with management's authorization. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by Ernst & Young LLP, independent chartered accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion.

The Audit and Environment (A&E) Committee of the Board of Directors is comprised of independent directors. The A&E Committee meets regularly with management, the internal auditors and the external auditors to satisfy itself that each is properly discharging its responsibilities, and to review the consolidated financial statements and MD&A. The A&E Committee reports its findings to the Board of Directors for consideration when approving the consolidated financial statements for issuance to the shareholder. The A&E Committee also recommends, for review by the Board of Directors and approval by the shareholder, the appointment of the external auditors. The internal and external auditors have full and free access to the A&E Committee.

TransAlta Utilities' Chief Executive Officer and Chief Financial Officer have certified TransAlta Utilities' annual disclosure documents as required by the Canadian securities regulators.

Signed by

Stephen G. Snyder
President & Chief Executive Officer

Ian A. Bourne
Executive Vice-President & Chief Financial Officer

Feb. 17, 2005

AUDITORS' REPORT

TO THE SHAREHOLDERS OF TRANSALTA UTILITIES CORPORATION

We have audited the consolidated balance sheets of TransAlta Utilities Corporation as at December 31, 2004 and 2003 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the corporation as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst + Young LLP

Chartered Accountants
Calgary, Canada

February 25, 2005

CONSOLIDATED STATEMENTS OF EARNINGS & RETAINED EARNINGS

(in millions of Canadian dollars except per share amounts)

Years ended Dec. 31	2004	2003
		(Restated, Note 1)
Revenues	$ 744.8	$ 731.5
Fuel expense	(209.7)	(186.4)
Gross margin	535.1	545.1
Operating expenses		
Operations, maintenance and administration	220.8	228.4
Depreciation and amortization *(Note 19)*	80.0	91.2
Taxes, other than income taxes	7.4	8.9
Loss (gain) on sale of assets	2.1	(10.5)
	310.3	318.0
Operating income	224.8	227.1
Interest expense *(Notes 7 and 16)*	(194.9)	(159.3)
Interest income *(Notes 6 and 16)*	151.5	95.0
Foreign exchange loss	–	(0.5)
Earnings from continuing operations before income taxes	181.4	162.3
Income tax expense *(Note 12)*	14.2	26.3
Earnings from continuing operations	167.2	136.0
Gain on disposal of discontinued operations, net of tax *(Note 2)*	6.8	–
Net earnings	$ 174.0	$ 136.0
Common share dividends *(Note 11)*	–	(700.0)
Reclassification of contributed surplus to retained earnings *(Notes 2 and 11)*	(8.1)	550.0
Retained earnings		
Opening balance	52.6	66.6
Closing balance	$ 218.5	$ 52.6
Weighted average common shares outstanding in the year	135.0	135.0
Basic and diluted earnings per common share		
Earnings from continuing operations	$ 1.24	$ 1.01
Earnings from discontinued operations	0.05	–
Net earnings	$ 1.29	$ 1.01

See accompanying notes.

CONSOLIDATED BALANCE SHEETS

(in millions of Canadian dollars)

Dec. 31	2004	2003
		(Restated, Note 1)
ASSETS		
Current assets		
Cash	$ –	$ 8.5
Accounts receivable *(Note 16)*	**102.2**	117.0
Loan receivable from TransAlta Corporation *(Note 16)*	**305.6**	231.4
Interest receivable from TransAlta Energy Corporation *(Note 16)*	**68.3**	19.8
Inventory	**14.3**	17.8
Future income tax assets *(Note 12)*	**9.0**	9.2
Income taxes receivable	**52.0**	100.7
	551.4	504.4
Property, plant and equipment *(Note 4)*		
Cost	**3,025.7**	2,973.5
Accumulated depreciation	**(1,633.8)**	(1,547.8)
	1,391.9	1,425.7
Long-term receivable from TransAlta Energy Corporation *(Notes 8 and 16)*	**1,942.7**	1,630.0
Other assets	**2.8**	3.5
Total assets	**$ 3,888.8**	$ 3,563.6
LIABILITIES AND SHAREHOLDER'S EQUITY		
Current liabilities		
Short-term debt *(Note 9)*	**$ 314.5**	$ –
Accounts payable, accrued liabilities and other *(Note 16)*	**125.9**	132.8
Income taxes payable	**9.1**	–
Current portion of long-term debt *(Note 10)*	**84.2**	102.2
	533.7	235.0
Long-term debt *(Note 10)*	**515.0**	602.8
Preferred securities *(Note 10)*	**1,800.0**	1,800.0
Asset retirement obligations *(Note 5)*	**98.1**	114.1
Future income tax liabilities *(Note 12)*	**198.0**	236.0
Other long-term liabilities *(Note 13)*	**44.3**	41.9
Common shareholder's equity		
Common shares *(Note 11)*	**250.9**	250.9
Contributed surplus	**230.3**	230.3
Retained earnings	**218.5**	52.6
	699.7	533.8
Total liabilities and shareholder's equity	**$ 3,888.8**	$ 3,563.6

Commitments and contingencies *(Notes 17 and 18)*

See accompanying notes.

On behalf of the Board:

Signed by
John T. Ferguson
Director

Signed by
William D. Anderson
Director

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of Canadian dollars)

Years ended Dec. 31	2004	2003
		(Restated, Note 1)
Operating activities		
Net earnings	$ 174.0	$ 136.0
Depreciation and amortization *(Note 19)*	100.9	105.8
Gain on sale of assets	(9.7)	(6.6)
Future income taxes	(8.8)	(39.5)
Asset retirement obligation costs settled *(Note 5)*	(10.4)	(5.3)
Asset retirement obligation accretion *(Note 5)*	8.4	8.3
Other non-cash items	–	(3.6)
	254.4	195.1
Change in non-cash operating working capital balances	10.4	71.3
Cash flow from operating activities	264.8	266.4
Investing activities		
Additions to property, plant and equipment	(86.8)	(76.0)
Proceeds on the sale of property, plant and equipment	2.1	76.8
Loan receivable from TransAlta Corporation	(74.2)	86.2
Purchase of preferred shares in TransAlta Energy Corporation	(312.7)	–
Other	–	(0.9)
Cash flow from (used in) investing activities	(471.6)	86.1
Financing activities		
Net proceeds from issuance of short-term debt	314.5	–
Repayment of long-term debt	(105.8)	(352.0)
Proceeds on issuance of preferred securities *(Note 10)*	–	700.0
Dividends on common shares *(Note 10)*	–	(700.0)
Distributions on preferred securities	(10.2)	–
Other	(0.2)	–
Cash flow from (used in) financing activities	198.3	(352.0)
Cash flow from (used in) operating, investing and financing activities	(8.5)	0.5
Cash, beginning of year	8.5	8.0
Cash, end of year	$ –	$ 8.5
Net cash taxes paid (received)	$ (6.3)	$ 18.1
Net cash interest paid	$ 94.7	$ 67.3

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dec. 31, 2004 and 2003

(Tabular dollar amounts in millions of Canadian dollars, unless otherwise noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Consolidation

The consolidated financial statements include the accounts of TransAlta Utilities Corporation (TransAlta Utilities or the corporation) and its wholly-owned subsidiaries. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP).

B. Use Of Estimates And Measurement Uncertainty

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates due to factors such as fluctuations in interest rates, currency exchange rates, inflation levels and commodity prices, changes in economic conditions and legislative and regulatory changes (*Notes 4, 5, 13, 14 and 18*).

C. Revenue Recognition

The majority of the corporation's revenues are derived from the production of power in Alberta. Revenues under Alberta Power Purchase Arrangements (PPAs) generally include one or more of the following components: fixed capacity payments for being available, energy payments for generation of electricity, availability payments or penalties for exceeding or not meeting availability targets, excess energy payments for power generation above committed capacity and ancillary services. Each is recognized upon output, delivery, or satisfaction of specific targets, all as specified by contractual terms. Revenues from non-contracted capacity are energy payments for each megawatt per hour (MWh) produced at market prices, and are recognized upon delivery.

D. Discontinued Operations

The results of discontinued operations are presented on a one-line basis in the consolidated statements of earnings. Interest expense, direct corporate overheads and income taxes are allocated to discontinued operations. General corporate overheads are not allocated to discontinued operations.

E. Inventory

The corporation's inventory balance represents coal which is valued at the lower of cost and market value, defined as net replacement value. Inventory cost is determined using moving average cost. The direct costing method is and is determined as the sum of all applicable expenditures and charges directly or indirectly incurred in bringing an inventory item to its existing condition and location.

F. Property, Plant And Equipment

The corporation's investment in property, plant and equipment (PP&E) is stated at original cost at the time of construction, purchase or acquisition. Original cost includes items such as materials, labour, interest and other appropriately allocated costs. As costs are expended for new construction, the entire amount is capitalized as PP&E on the consolidated balance sheet and is subject to depreciation upon commencement of commercial operations. The cost of routine maintenance and repairs, such as inspections and corrosion removal, and the replacement of minor parts, are charged to expense as incurred. Certain expenditures relating to replacement of components incurred during major maintenance are capitalized and amortized over the estimated benefit period of such expenditures. A component is a tangible portion of the asset that can be separately identified as an asset and depreciated over its own expected useful life, and is expected to provide a benefit of greater than one year.

The estimate of the useful life of PP&E is based on current facts and past experience, and takes into consideration existing long-term sales agreements and contracts, current and forecasted demand and the potential for technological obsolescence. The useful life is used to estimate the rate at which the PP&E is amortized. These estimates are subject to revision in future periods based on new or additional information. Depreciation and amortization is calculated using straight-line, declining balance and unit of production methods. Coal rights are amortized on a unit of production basis, based on the estimated mine reserve.

TransAlta Utilities capitalizes interest on capital invested in projects that are under construction. Upon commencement of plant operations, capitalized interest, as a portion of the total cost of the plant, is amortized over the estimated useful life of the plant.

The corporation determines those debt instruments that best represent a reasonable measure of the cost of financing the assets under construction. These debt instruments and associated interest costs are included in the calculation of the weighted average interest rate used for capitalizing interest.

On an annual basis, and when indicators of impairment exist, TransAlta Utilities determines whether the net carrying amount of PP&E is recoverable from future undiscounted cash flows. Factors which could indicate an impairment exists include significant underperformance relative to historical or projected future operating results, significant changes in the manner or use of the assets, significant negative industry or economic trends, or a change in the strategy for the corporation's overall business. In some cases, these events are clear. However, in many cases, a clearly identifiable event indicating possible impairment does not occur. Instead, a series of individually insignificant events occur over a period of time leading to an indication that an asset may be impaired. As a result, events occurring in these situations may not be known until a date subsequent to their occurrence.

The corporation's businesses, the markets and business environment are continually monitored, and judgments and assessments are made to determine whether an event has occurred that indicates possible impairment. If such an event has occurred, an estimate is made of the future undiscounted cash flows from the PP&E. If the total of the undiscounted future cash flows, excluding financing charges, is less than the carrying amount of the PP&E, an asset impairment must be recognized in the consolidated financial statements. The amount of the impairment charge to be recognized is calculated by subtracting the fair value of the asset from the carrying value of the asset. Fair value is the amount at which an item could be bought or sold in a current transaction between willing parties, and is estimated by calculating the present value of expected future cash flows related to the asset.

G. Asset Retirement Obligation

Effective Jan. 1, 2003, TransAlta Utilities early adopted the new Canadian Institute of Chartered Accountants (CICA) standard for accounting for asset retirement obligations. Under the new standard, the corporation recognizes asset retirement obligations in the period in which they are incurred if a reasonable estimate of a fair value can be determined. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. The liability is accreted over the estimated time period until settlement of the obligation and the asset is depreciated over the estimated useful life of the asset (*Note 5*).

H. Income Taxes

The corporation uses the liability method of accounting for income taxes. Under the liability method, income taxes are recognized for the differences between financial statement carrying values and the respective income tax basis of assets and liabilities (temporary differences), the carry-forward of unused tax losses and income tax reductions. Future income tax assets and liabilities are measured using income tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period the change is substantively enacted. Future income tax assets are evaluated annually and if realization is not considered 'more likely than not', a valuation allowance is provided.

I. Employee Future Benefits

The corporation accrues its obligations under employee benefit plans and the related costs, net of plan assets. The cost of pensions and other post-employment and post-retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on services and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs. The defined benefit pension plans are based on an employee's final average earnings and years of service. Pension benefits will increase annually by two per cent. For the purpose of calculating the expected return on plan assets, those assets are valued at quoted market value. The discount rate used to calculate the interest cost on the accrued benefit obligation is determined by reference to market interest rates at the balance sheet date on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment (EARSL). The excess of the net cumulative unamortized actuarial gain or loss over 10 per cent of the greater of the accrued benefit obligation and the market value of plan assets at the beginning of the year is amortized over the average remaining service period of the active employees. When the restructuring of a benefit plan gives rise to both a curtailment and settlement of obligations, the curtailment is accounted for prior to the settlement. Transition obligations and assets arising from the prospective adoption of new accounting standards are amortized over EARSL.

J. Derivatives And Financial Instruments

Physical and financial swaps, forward sales contracts and options are used to hedge the corporation's exposure to fluctuations in electricity and natural gas prices to output from the plants. Under GAAP, if hedging criteria are met (described below), gains and losses on these derivatives are deferred and recognized in earnings in the same period and financial statement caption as the hedged exposure (settlement accounting). The derivatives are not recorded on the balance sheet.

Foreign currency forward contracts are used to hedge the foreign exchange exposures resulting from anticipated contracts and firm commitments denominated in foreign currencies. Under GAAP, if hedge criteria are met, these derivatives are not recognized on the balance sheet. Upon settlement of the derivative, any gain or loss on the forward contracts is deferred and included in other assets or accounts payable, accrued liabilities and other, and is included in the cost of the asset when the asset is purchased and depreciated over the asset's estimated useful life (settlement accounting).

Interest rate swaps are used to manage the impact of fluctuating interest rates on existing debt. These instruments are not recognized on the balance sheet under GAAP. Interest rate swaps require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. If hedge criteria are met, interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps (settlement accounting).

To be accounted for as a hedge under GAAP, a derivative must be designated and documented as a hedge, and must be effective at inception and on an ongoing basis. The documentation defines all relationships between hedging instruments and hedged items, as well as the corporation's risk management objective and strategy for undertaking various hedge transactions. The process includes linking derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or anticipated transactions. The corporation also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used are highly effective in offsetting changes in fair values or cash flows of hedged items. Hedge effectiveness of cash flows is achieved if the derivatives' cash flows substantially offset the cash flows of the hedged item and the timing of the cash flows is similar. Hedge effectiveness of fair values is achieved if changes in the fair value of the derivative substantially offset changes in the fair value of the item hedged. If the above hedge criteria are not met, the derivative is accounted for on the consolidated balance sheet at fair value, with the initial fair value and subsequent changes in fair value recorded in earnings in the period of change.

If a derivative that has been accorded hedge accounting matures, expires, is sold, terminated or cancelled, and is not replaced as part of the corporation's hedging strategy, the termination gain or loss is deferred and recognized when the gain or loss on the item hedged is recognized. If a designated hedged item matures, expires, is sold, extinguished or terminated, and the hedged item is no longer probable of occurring, any previously deferred amounts associated with the hedging item are recognized in current earnings along with the corresponding gains or losses recognized on the hedged item. If a hedging relationship is terminated or ceases to be effective, hedge accounting is not applied to subsequent gains or losses. Any previously deferred amounts are carried forward and recognized in earnings in the same period as the hedged item.

K. Changes In Accounting Standards

The CICA has amended the standard on the presentation of liabilities and equity effective for years ending on or after Nov. 1, 2004. The standard addresses the situation in which an entity has a contractual obligation of a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments, but the entity must, or can, settle the obligation by delivery of its own equity instruments (the number of which depends on the amount of the obligation). Such an obligation is a financial liability of the entity. TransAlta Utilities early adopted this standard effective Jan. 1, 2004 and has therefore presented the corporation's preferred securities as financial liabilities on the balance sheet. Preferred securities distributions are included in interest expense on the statement of earnings and are therefore included as a deduction in arriving at net earnings (*Note 7*). Prior periods have been restated and as a result, preferred securities distributions, net of tax, have been reduced to nil in 2004 and 2003. Net interest expense for the year ended Dec. 31, 2004 was increased by $138.6 million (2003 - $83.9 million), and income tax expense for the year ended Dec. 31, 2004 was decreased by $46.9 million (2003 - $30.9 million). Preferred securities have been increased to $1,800.0 million from $1,749.8 million as at Dec. 31, 2003 with a corresponding decrease in long-term debt.

On Jan.1, 2004, TransAlta Utilities changed its accounting policy on the presentation of its preferred share investment in TransAlta Energy Corporation (TEC), a commonly controlled enterprise. When a preferred share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument is a financial liability of the issuer and hence a financial asset of the holder. The preferred shares are disclosed as a long-term receivable from TEC on the balance sheet, and dividends earned on the preferred shares are disclosed as interest income on the statement of earnings (*Note 6*). Prior periods have been restated to reflect this change. The Dec. 31, 2003 income statement has been restated to present $79.0 million of dividend income as interest income. This restatement resulted in no change to net earnings.

In March 2004, the U.S. Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-02, "Whether Mineral Rights Are Tangible or Intangible Assets," that mineral rights, as defined in the Issue, are tangible assets. As a result of this decision, TransAlta Utilities accounts for coal rights under Canadian GAAP as tangible assets. Prior period amounts of $58.8 million at Dec. 31, 2003 have been reclassified from intangible assets to tangible assets. There was no effect on net earnings as a result of the reclassification.

2. DISCONTINUED OPERATIONS

A. D&R Sale

Effective Aug. 31, 2000, TransAlta Utilities sold its Distribution and Retail (D&R) operations, with a book value of $621.0 million to TEC in exchange for $855.1 million of preferred shares of TEC which were redeemed on Sept. 29, 2000. As the sale of the D&R operations from the corporation to TEC constituted a related party transaction, no gain on disposal was recorded and the $234.1 million excess of the proceeds received from TEC over the net book value of the D&R operations was recorded as contributed surplus. In 2000, pursuant to a Board of Directors' resolution, the contributed surplus was reclassified to retained earnings. In 2004, a regulatory decision relating to recovery of certain costs was issued that allowed TransAlta to finalize outstanding items relating to the sale of the D&R operations. As a result, $10.2 million of unused provision against closing costs has been released to income as a gain on disposal of discontinued operations ($6.8 million after tax). In addition, the redemption value of the preferred shares has been reduced by $10.2 million which, pursuant to the resolution of the Board of Directors, has been recorded as a charge to retained earnings. These adjustments were not made prior to 2004 as the corporation was awaiting a regulatory decision in order to finalize the purchase price.

B. Transmission Sale

TransAlta Utilities sold its Transmission operations, with a book value of $632.8 million, to TEC on April 22, 2002. In exchange, TransAlta Utilities received preferred shares of TEC that were redeemable for $818.2 million. The sale of the Transmission operations to TEC constituted a related party transaction and therefore no gain on disposal was recorded. These preferred shares were redeemed on May 31, 2002 and the difference between the book value of the Transmission operations and the preferred shares was recorded as an adjustment to contributed surplus. In 2002, pursuant to a Board of Directors' resolution, the contributed surplus was reclassified to retained earnings. In June 2004, a settlement was reached to finalize the sale of the Transmission operations which resulted in an adjustment to the redemption value of the preferred shares of $2.1 million. The $2.1 million increased the redemption value of the preferred shares to $820.3 million and pursuant to a resolution of the Board of Directors, the adjustment has been charged to retained earnings.

3. DISPOSALS - CONTINUING OPERATIONS

On May 9, 2003, the corporation finalized the sale of its head office building in Calgary, Alberta to an unrelated party for an agreed value of $65.8 million.

On July 18, 2003, the corporation sold its 50 per cent interest in the Sheerness Generating Station with a net book value of $435.8 million, to TEC in exchange for 6.75 per cent cumulative redeemable preferred shares with a face value of $630.0 million, which approximated the fair value of the Sheerness Generating Station. The exchange amount was determined based on an estimate of the future net cash flows of the Sheerness Generating Station. As the sale of this plant from the corporation to TEC constituted a related party transaction, no gain on disposal was recorded, and the $213.0 million in excess of proceeds received by the corporation over the net book value of the Sheerness Generating Station was recorded as contributed surplus. The corporation transferred $3.7 million of asset retirement obligations and $15.1 million of working capital and future income tax liability.

On Dec. 31, 2003, the corporation completed the sale of 539 acres of undeveloped land at Seebe, Alberta for $11.0 million, resulting in a gain on sale of $10.5 million.

4. PROPERTY, PLANT AND EQUIPMENT

				2004			2003
	Depreciation rates	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Thermal generation	3% - 33%	$ 1,676.3	$ 887.2	$ 789.1	$ 1,620.8	$ 839.0	$ 781.8
Mining property and equipment	4% - 33%	486.0	292.1	193.9	488.5	270.3	218.2
Hydro generation	2% - 5%	342.0	189.1	152.9	339.0	181.1	157.9
Thermal environmental equipment	4% - 13%	323.6	220.6	103.0	323.6	214.2	109.4
Capital spares and other	2% - 50%	71.7	20.0	51.7	74.1	18.9	55.2
Coal rights[1]	–	70.8	15.3	55.5	73.8	15.3	58.5
Land	–	25.8	–	25.8	24.9	–	24.9
Assets under construction	–	10.7	–	10.7	10.7	–	10.7
Transmission systems	2% - 20%	18.8	9.5	9.3	18.1	9.0	9.1
		$ 3,025.7	$ 1,633.8	$ 1,391.9	$ 2,973.5	$ 1,547.8	$ 1,425.7

[1] *Coal rights are amortized on a unit of production basis, based on the estimated mine reserve.*

The corporation capitalized interest during construction of $nil (2003 - $0.8 million) to assets under construction.

5. ASSET RETIREMENT OBLIGATIONS

TransAlta Utilities has recorded an asset retirement obligation for all generating facilities, as it is legally required to remove the facilities at the end of their useful lives and restore the plant and mine sites to their original condition. For the hydro facilities, the corporation is required to remove the generating equipment, but is not legally required to remove the structures. TransAlta has recognized legal obligations arising from government legislation, written agreements between entities and case law. The asset retirement liabilities are recognized when the asset retirement obligation is incurred. Asset retirement liabilities for coal mines are incurred over time, as new areas are mined, and a portion of the liability is settled over time as areas are reclaimed prior to final pit reclamation.

A reconciliation between the opening and closing asset retirement obligations balance is provided below:

Balance, Jan. 1, 2002	$ 107.9
Liabilities incurred in period	6.9
Liabilities transferred on the sale of the Sheerness plant	(3.7)
Liabilities settled in period	(5.3)
Accretion expense	8.3
Balance, Dec. 31, 2003	$ 114.1
Liabilities incurred in period	9.5
Liabilities settled in period	(10.4)
Accretion expense	8.4
Revisions in estimated cash flows	(23.5)
Balance, Dec. 31, 2004	**$ 98.1**

TransAlta Utilities estimates that the undiscounted amount of cash flow required to settle asset retirement obligations is approximately $587.2 million which will be incurred between 2005 and 2072. The majority of the costs will be incurred between 2020 and 2030. A discount rate of eight per cent was used to calculate the carrying value of the asset retirement obligations. No assets have been legally restricted for settlement of the liability.

6. INTEREST INCOME

TransAlta Utilities' has presented the corporation's preferred share investment as a long-term receivable on the consolidated balance sheet (*Note 1*). Dividend income is included in interest income as shown below:

	2004	2003
Interest income - preferred share investment in TEC	$ 131.4	$ 79.0
Other interest income	20.1	16.0
Total interest income	$ 151.5	$ 95.0

7. INTEREST EXPENSE

TransAlta Utilities' preferred securities are classified as financial liabilities on the consolidated balance sheet (*Note 1*). Preferred securities distributions are included in interest expense as shown below:

	2004	2003
Interest expense - preferred securities	$ 138.6	$ 86.2
Interest on long-term debt	56.3	73.1
Total interest expense	$ 194.9	$ 159.3

8. LONG-TERM RECEIVABLE FROM TRANSALTA ENERGY CORPORATION

In June 2004, TransAlta Utilities acquired a US$255.2 million preferred share investment in TEC using funds from a loan from TransAlta Corporation (TAC), the corporation's parent. The balance of the loan at Dec. 31, 2004 in Canadian dollars is $312.7 million. The preferred shares bear a dividend rate of 5.8 per cent per annum and are redeemable at the option of the holder or issuer.

On July 18, 2003, in connection with the sale of the Sheerness Generating Station, the corporation received preferred shares in TEC for $630.0 million. These cumulative preferred shares hold a dividend rate of 6.75 per cent payable quarterly, and interest accrues and compounds on any unpaid dividends at a rate of 10.4 per cent per annum commencing 30 days following the date such unpaid dividends become payable. These shares are redeemable at the option of the corporation.

On May 3, 2001 as part of a capital restructuring, the corporation purchased preferred shares in TEC for $1.0 billion. These shares hold a dividend rate of 7.9 per cent and are paid quarterly. These shares are redeemable at the option of the corporation.

9. SHORT-TERM DEBT

	2004		2003	
	Outstanding	Interest[1]	Outstanding	Interest[1]
Demand loan - TAC[2]	$ 312.7	5.8%	$ –	–
Bank debt	1.8	–	–	–
	$ 314.5		$ –	

1 *Interest is an average rate weighted by principal amounts outstanding.*

2 *In June 2004, TAC lent the corporation US$256.0 million. The outstanding principal amount and interest on the loan are due on demand on three business days notice*

10. LONG-TERM DEBT

A. Amounts Outstanding

	2004		2003	
	Outstanding	**Interest rate**[1]	Outstanding	Interest rate[1]
Preferred securities, due 2050 and 2052[2]	**$ 1,800.0**	**7.7%**	$ 1,800.0	7.7%
Debentures, due 2005 - 2033[3]	**598.4**	**6.5%**	698.3	6.4%
Capital lease obligation, due 2005[4]	**0.8**	**8.0%**	6.7	9.1%
	$ 2,399.2		$ 2,505.0	
Less current portion	**84.2**		102.2	
	$ 2,315.0		$ 2,402.8	

1 *Interest is an average rate weighted by principal amounts outstanding.*

2 *The preferred securities consist of $1.1 billion due in 2050 and $700.0 million due in 2052. The $1.1 billion are subordinated, unsecured and hold a dividend rate of 7.8 per cent which is paid quarterly. These preferred securities are redeemable at the option of the corporation in whole or in part on or after May 3, 2006 for a redemption amount equal to the subscription price plus accrued and unpaid dividends. The $700.0 million are subordinated, unsecured and hold a dividend rate of 7.5 per cent which is paid quarterly. These preferred securities are redeemable at the option of the holder (TAC) in whole or in part after the date of issue, for preferred shares at a subscription price of $25 per share. If converted, these preferred shares shall be redeemable in 2008 at the option of the corporation, in whole or in part for a redemption amount equal to the subscription price plus accrued and unpaid dividends (in connection with the capital restructuring, the corporation declared a cash dividend to TAC of $700.0 million on Dec. 31, 2003). For both the amounts due in 2050 and 2052, interest accretion at the coupon rate is included in interest expense.*

3 *The debentures bear interest at fixed rates ranging from 5.49 per cent to 8.6 per cent. A floating charge on the property and assets of the corporation has been provided as collateral. Debentures of $150.0 million (2004 - $250.0 million) are held by TAC with an interest rate of 6.520 per cent and mature in 2009. Debentures of $100.0 million maturing in 2023 and $50.0 million maturing in 2033 are redeemable at the option of the holder in 2008 and 2009, respectively.*

4 *Certain coal mining capital assets have been provided as collateral. The maximum collateral amount equates the capital lease obligation. The obligation is due in 2005 and bears interest at a fixed rate of eight per cent.*

B. Principal Repayments

Long-term debt principal amounts are due in the following years:

2005	$ 84.2
2006	100.0
2007	–
2008	115.0
2009	150.0
2010 and thereafter	1,950.0
	$ 2,399.2

C. Letters Of Credit And Guarantees

In the normal course of operations, TransAlta Utilities enters into agreements to provide financial or performance assurances to third parties. These include guarantees, letters of credit and surety bonds which are entered into to support or enhance creditworthiness in order to facilitate the extension of sufficient credit for construction projects and equipment purchases.

At Dec. 31, 2004, the corporation had $59.8 million (2003 - $60.5 million) in letters of credit outstanding and provided guarantees for TAC's issued commercial paper with a maximum exposure of $200.0 million (2003 - $nil). All letters of credit expire in 2005. No surety bonds were outstanding at Dec. 31, 2004 or 2003.

11. SHARE CAPITAL

Common Shares Issued And Outstanding

	2004		2003	
	Common shares (millions)	Amount	Common shares (millions)	Amount
Issued and outstanding, beginning of year	135.0	$ 250.9	135.0	$ 800.9
Reduction of stated capital	–	–	–	(550.0)
Issued and outstanding, end of year	135.0	$ 250.9	135.0	$ 250.9

The corporation is authorized to issue an unlimited number of voting common shares without nominal or par value.

At Dec. 31, 2004, TransAlta Utilities had 135.0 million (2003 - 135.0 million) common shares issued and outstanding.

Effective Dec. 31, 2003, pursuant to a resolution of the Board of Directors, the corporation reduced its stated capital and created contributed surplus of $550.0 million. The $550.0 million of contributed surplus was then reclassified to retained earnings and the corporation declared a cash dividend of $700.0 million to TAC.

12. INCOME TAXES

A. Statements Of Earnings

I. Rate Reconciliations

	2004	2003
Earnings from continuing operations before income taxes	$ 181.4	$ 162.3
Statutory Canadian federal and provincial income tax rate	33.9%	36.8%
Expected taxes on income	61.4	59.7
Increase (decrease) in income taxes resuling from:		
Non-taxable dividend income	(44.5)	(29.0)
Manufacturing and processing rate reduction	(1.7)	(3.5)
Effect of tax rate changes	(1.5)	2.1
Resource allowance net of non-deductible royalties	(1.6)	(2.6)
Non-deductible costs and other	–	(2.7)
Large corporations tax net of surtax	2.1	2.3
Income tax expense	$ 14.2	$ 26.3
Effective tax rate	7.9%	16.2%

The corporation's operations are complex, and the computation and provision for income taxes involves tax interpretations, regulations and legislation that are continually changing. The corporation's tax filings are subject to audit by taxation authorities. The outcome of some audits may change the tax liability of the corporation and such adjustment could be material. Management believes it has adequately provided for income taxes based on all information currently available.

II. Components Of Income Tax Expense

	2004	2003
Current tax expense	$ 26.4	$ 34.9
Future income tax expense related to the origination and reversal of temporary differences	(10.7)	(10.7)
Future income tax expense resulting from changes in tax rates or laws	(1.5)	2.1
Income tax expense	$ 14.2	$ 26.3

B. Balance Sheets

Significant components of the corporation's future income tax assets and liabilities are as follows:

	2004	2003
Asset retirement obligations costs	$ 40.2	$ 35.9
Property, plant and equipment	(237.6)	(271.7)
Other deductible temporary differences	8.4	9.0
	$ (189.0)	$ (226.8)

Presented in the balance sheet as follows:

	2004	2003
Assets - current	$ 9.0	$ 9.2
Liabilities - long-term	(198.0)	(236.0)
	$ (189.0)	$ (226.8)

13. EMPLOYEE FUTURE BENEFITS

A. Description

The corporation has a registered pension plan with defined benefit and defined contribution options and a supplemental defined benefit plan covering substantially all employees of the corporation. The defined benefit option of the registered pension plan ceased for new employees on June 30, 1998. The latest actuarial valuations of the registered and supplemental pension plans were as at Dec. 31, 2004. The measurement date used to determine plan assets and accrued benefit obligation was Dec. 31, 2004. The effective date of the next required valuation for funding purposes is Dec. 31, 2007. The supplemental pension plan is an obligation of the corporation. The corporation is not obligated to fund the supplemental plan but is obligated to pay benefits under the terms of the plan as they come due.

The corporation provides other health and dental benefits to the age of 65 for both disabled members (other post-employment benefits) and retired members (other post-retirement benefits). The latest actuarial valuation of these other plans was as at April 30, 2002. The measurement date used to determine the accrued benefit obligation was also April 30, 2002. The effective date of the next required valuation for funding purposes is Dec. 31, 2005.

B. Costs Recognized

Year ended Dec. 31, 2004	Registered	Supplemental	Other	Total
Current service cost	$ 2.5	$ 1.0	$ 0.3	$ 3.8
Interest cost	17.3	2.0	0.5	19.8
Actual return on plan assets	(29.4)	–	–	(29.4)
Actuarial (gains) losses in 2004	11.3	(1.4)	–	9.9
Plan amendments in 2004	–	–	3.5	3.5
Difference between expected return and actual return on plan assets	8.7	–	–	8.7
Difference between actuarial (gain) loss recognized for the year and actual actuarial (gain) loss on accrued benefit obligation for year	(9.8)	1.8	0.2	(7.8)
Difference between amortization of past service costs for the year and actual plan amendments for the year	0.1	(0.1)	(3.5)	(3.5)
Amortization of net transition obligation (asset)	(8.5)	0.3	–	(8.2)
Defined benefit (income) cost	(7.8)	3.6	1.0	(3.2)
Defined contribution option expense of registered pension plan	8.4	–	–	8.4
Net expense	$ 0.6	$ 3.6	$ 1.0	$ 5.2

Year ended Dec. 31, 2003	Registered	Supplemental	Other	Total
Current service cost	$ 2.3	$ 1.3	$ 0.3	$ 3.9
Interest cost	18.2	2.1	0.5	20.8
Actual return on plan assets	(31.5)	–	–	(31.5)
Actuarial (gains) losses in 2003	20.3	(0.6)	0.3	20.0
Difference between expected return and actual return on plan assets	10.1	–	–	10.1
Difference between actuarial (gain) loss recognized for the year and actual actuarial (gain) loss on accrued benefit obligation for year	(19.7)	1.2	(0.1)	(18.6)
Difference between amortization of past service costs for the year and actual plan amendments for the year	0.1	(0.1)	–	–
Amortization of net transition obligation (asset)	(8.8)	0.3	–	(8.5)
Defined benefit (income) cost	(9.0)	4.2	1.0	(3.8)
Defined contribution option expense of registered pension plan	9.3	–	–	9.3
Net expense	$ 0.3	$ 4.2	$ 1.0	$ 5.5

C. Status of Plans

Year ended Dec. 31, 2004	**Registered**	**Supplemental**	**Other**
Market value of plan assets	**$ 316.9**	**$ 1.3**	**$ –**
Accrued benefit obligation	**327.2**	**34.7**	**12.3**
Funded status - plan deficit	**(10.3)**	**(33.4)**	**(12.3)**
Amounts not yet recognized in financial statements:			
Unrecognized past service costs	**0.4**	**(0.4)**	**3.5**
Unamortized transition (asset) obligation	**(51.1)**	**2.8**	**–**
Unamortized net actuarial gains	**45.4**	**6.8**	**2.9**
Total recognized in financial statements:			
Accrued benefit liability	**$ (15.6)**	**$ (24.2)**	**$ (5.9)**
Amortization period in years (EARSL)	**9**	**9**	**10**

Year ended Dec. 31, 2003	Registered	Supplemental	Other
Market value of plan assets	$ 311.3	$ 0.8	$ –
Accrued benefit obligation	309.7	33.9	8.7
Funded status - plan surplus (deficit)	1.6	(33.1)	(8.7)
Amounts not yet recognized in financial statements:			
Unrecognized past service costs	0.5	(0.5)	–
Unamortized transition (asset) obligation	(61.6)	3.2	–
Unamortized net actuarial gains	46.0	6.5	2.7
Total recognized in financial statements:			
Accrued benefit liability	$ (13.5)	$ (23.9)	$ (6.0)
Amortization period in years (EARSL)	9	9	10

The classification of the accrued benefit liability on the consolidated balance sheet is as follows:

Year ended Dec. 31, 2004	**Registered**	**Supplemental**	**Other**
Accrued current liabilities	**$ –**	**$ 0.6**	**$ 0.8**
Other long-term liabilities	**15.6**	**23.6**	**5.1**
Accrued benefit liability	**$ 15.6**	**$ 24.2**	**$ 5.9**

Year ended Dec. 31, 2003	Registered	Supplemental	Other
Accrued current liabilities	$ –	$ 0.5	$ 1.0
Other long-term liabilities	13.5	23.4	5.0
Accrued benefit liability	$ 13.5	$ 23.9	$ 6.0

D. Contributions

Expected cash flows are as follows:

	Registered	Supplemental	Other	Total
Employer contributions				
2005 (expected)	$ –	$ 0.6	$ –	$ 0.6
Expected benefit payments				
2005	21.2	1.6	0.9	23.7
2006	21.4	1.7	0.9	24.0
2007	21.7	1.9	1.0	24.6
2008	21.9	1.9	1.0	24.8
2009	22.3	2.0	1.0	25.3
2010 - 2014	116.0	11.6	5.5	133.1

E. Reconciliation Of Plan Assets

	Registered	Supplemental	Other
Fair value of plan assets at Dec. 31, 2002	$ 322.0	$ 0.4	$ –
Contributions	–	0.4	–
Transfers to defined contribution option	(8.7)	–	–
Benefits paid	(23.8)	–	–
Actual return on plan assets	31.5	–	–
Adjustment for decrease in plan members	(9.7)	–	–
Fair value of plan assets at Dec. 31, 2003	$ 311.3	$ 0.8	$ –
Contributions	–	0.5	–
Transfers to defined contribution option	(8.4)	–	–
Benefits paid	(22.1)	–	–
Actual return on plan assets	29.4	–	–
Adjustment for additional plan members	6.7	–	–
Fair value of plan assets at Dec. 31, 2004	**$ 316.9**	**$ 1.3**	**$ –**

The corporation's investment policy is to achieve a consistently high investment return over time while maintaining an acceptable level of risk to satisfy the benefit obligations of the pension plans. The goal is to maintain a long-term rate of return on the fund that exceeds inflation by four per cent. The pension fund may be invested in publicly traded common or preferred equity shares, rights or warrants; convertible debentures or preferred securities; bonds, debentures, mortgages, notes or other debt instruments of government agencies or corporations; private company securities; guaranteed investment contracts; term deposits; cash or money market securities; and mutual or pooled funds eligible for pension fund investment. The target allocation percentages are 60 per cent equity and 40 per cent fixed income. Cash and money market instruments may be held from time to time as short-term investment decisions or as defensive reserves within the portfolios of each asset class. The fund may invest in derivatives for the purpose of hedging the portfolio or altering the desired mix of the fund. Derivative transactions that leverage the fund in any way are not permitted without the specific approval of the Pension Committee.

The allocation of plan assets by major asset category at Dec. 31, 2004 and 2003 is as follows:

Year ended Dec. 31, 2004	**Registered**	**Supplemental**
Equity securities	**54.4%**	**–**
Debt securities	**44.1%**	**–**
Cash equivalents	**1.5%**	**100.0%**
Total	**100.0%**	**100.0%**

Year ended Dec. 31, 2003	Registered	Supplemental
Equity securities	53.5%	–
Debt securities	45.7%	–
Cash equivalents	0.8%	100.0%
Total	100.0%	100.0%

Plan assets include common shares of the corporation having a fair value of $0.7 million at Dec. 31, 2004 (2003 - $0.7 million). The corporation charged the registered plan $0.1 million for administrative services provided for the year ended Dec. 31, 2004 (2003 - $0.1 million).

F. Reconciliation Of Accrued Benefit Obligations

	Registered	Supplemental	Other
Accrued benefit obligation as at Dec. 31, 2002	$ 300.9	$ 34.1	$ 8.8
Current service cost	2.3	1.3	0.3
Interest cost	18.2	2.1	0.5
Expected benefits paid	(22.6)	(1.3)	(0.8)
Transfers	0.6	(0.6)	–
Actuarial loss (gain)	20.3	(0.6)	0.3
Adjustment for decrease in plan members	(10.0)	(1.1)	(0.4)
Accrued benefit obligation as at Dec. 31, 2003	$ 309.7	$ 33.9	$ 8.7
Current service cost	2.5	1.0	0.3
Interest cost	17.3	2.0	0.5
Expected benefits paid	(20.6)	(1.5)	(1.0)
Past service charge	–	–	3.5
Actuarial loss (gain)	11.3	(1.4)	–
Adjustment for additional plan members	7.0	0.7	0.3
Accrued benefit obligation as at Dec. 31, 2004	**$ 327.2**	**$ 34.7**	**$ 12.3**

G. Assumptions

The significant actuarial assumptions adopted in measuring the corporation's accrued benefit obligations were as follows:

Year ended Dec. 31, 2004	**Registered**	**Supplemental**	**Other**
Accrued benefit obligation as at Dec. 31			
Discount rate	**5.5%**	**5.5%**	**5.5%**
Rate of compensation increase	**3.5%**	**3.5%**	**–**
Benefit cost for year ended Dec. 31			
Discount rate	**5.8%**	**5.8%**	**5.8%**
Rate of compensation increase	**3.5%**	**3.5%**	**–**
Expected rate of return on plan assets	**7.0%**	**–**	**–**
Assumed health care cost trend rate at Dec. 31			
Health care cost escalation	**–**	**–**	**10.0%**[1]
Dental care cost escalation	**–**	**–**	**4.0%**
Provincial health care premium escalation	**–**	**–**	**2.5%**

Year ended Dec. 31, 2003	Registered	Supplemental	Other
Accrued benefit obligation as at Dec. 31			
Discount rate	5.8%	5.8%	5.8%
Rate of compensation increase	3.5%	3.5%	–
Benefit cost for year ended Dec. 31			
Discount rate	6.3%	6.3%	6.3%
Rate of compensation increase	3.5%	3.5%	–
Expected rate of return on plan assets	7.0%	–	–
Assumed health care cost trend rate at Dec. 31			
Health care cost escalation	–	–	7.0%[2]
Dental care cost escalation	–	–	3.5%
Provincial health care premium escalation	–	–	2.5%

1 *For 10 years from Dec. 31, 2004, and five per cent thereafter.*

2 *For five years from Dec. 31, 2003, and five per cent thereafter.*

The expected long-term rate of return on plan assets is based on past performance and economic forecasts for the types of investments held by the plan. The estimated rate of return is lower than the historical returns of the appropriate indices.

Sensitivity to changes in assumed health care cost trend rates are as follows:

	One percentage point increase	One percentage point decrease
Effect on total service and interest costs	$ 0.1	$ (0.1)
Effect on post-retirement benefit obligation	$ 1.1	$ (1.0)

14. FINANCIAL RISK MANAGEMENT

A. Interest Rate Risk Management

The fair value of the corporation's fixed interest long-term debt changes as interest rates change, with details as follows:

	2004		2003	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Long-term debt	**$ 2,399.2**	**$ 2,421.8**	$ 2,505.0	$ 2,531.7

B. Foreign Exchange Risk Management

The corporation has no future foreign currency obligations (2003 - $nil).

C. Credit Risk Management

The corporation actively manages its exposure to credit risk by assessing the ability of counterparties to fulfill their obligations under the related contracts prior to entering into such contracts, and continually monitors these exposures. The corporation makes detailed assessments of the credit quality of all counterparties and, where appropriate, obtains corporate guarantees and/or letters of credit to support the ultimate collection of these receivables. TransAlta Utilities is exposed to minimal credit risk for PPAs because under the terms of these arrangements all receivables are guaranteed by letters of credit.

15. JOINT VENTURES

The Sheerness Generating Station is a coal-fired plant in Alberta. TransAlta Utilities owned a 50 per cent interest in the joint venture, which is operated by Canadian Utilities. TransAlta Utilities' interest in the Sheerness Generating Station was sold on July 18, 2003 to TEC (*Note 3*). The information below summarizes the results of operations and cash flows relating to the corporation's pro-rata interest in the Sheerness Generating Station:

	2004	2003
Results of operations		
Revenues	**$ –**	$ 70.8
Expenses	**–**	(35.3)
Proportionate share of net earnings	**$ –**	$ 35.5
Cash flows		
Cash flow from operations	**$ –**	$ 49.2
Cash flow used in investing activities	**–**	(2.9)
Cash flow used in financing activities	**–**	(65.6)
Proportionate share of decrease in cash and cash equivalents	**$ –**	$ (19.3)

16. RELATED PARTY TRANSACTIONS

During the year, the corporation engaged in related party transactions with TAC and TEC. These transactions were recorded at their exchange amounts and settled under commercial terms. The exchange amounts are estimated based on rates and terms which would have been used for similar transactions with third parties or the amounts approximate cost. See *Notes 2 and 3* for specific related party transactions regarding the sale of the D&R and Transmission operations and the sale of the Sheerness Generating Station.

A. Transactions

	2004	2003
Operations, maintenance and administration expenses (income)		
TAC - administrative services	**$ 41.9**	$ 34.6
TEC - management fees and other	**(0.3)**	(0.9)
Interest expense		
TAC	**26.6**	18.2
Preferred securites	**138.6**	86.2
Interest income		
TAC	**(20.1)**	(16.0)
Long-term receivable from TEC[1]	**(131.4)**	(79.0)

1 *Interest income represents dividend income earned on the corporation's investment in TEC's preferred shares, presented as a long-term receivable from TEC.*

B. Balances

The amounts due from (to) related parties, exclusive of related party debt *(Note 10)*, were as follows:

	2004	2003
Accounts receivable (payable)[1]		
TAC	**$ (49.0)**	$ (56.5)
TEC (including subsidiaries)	**4.3**	41.8
Interest receivable from TEC[2]	**68.3**	19.8
Loan receivable from TAC[3]	**305.6**	231.4
Long-term receivable from TEC[4]	**1,942.7**	1,630.0

1 *The accounts receivable and accounts payable balances are due on demand and have arisen from the transactions referred to previously and are non-interest bearing.*

2 *Interest receivable represents dividend income earned on the corporation's investment in TEC's preferred shares, presented as a long-term receivable from TEC.*

3 *The loan receivable bears interest at bankers acceptance rates and has no fixed terms of repayment.*

4 *The long-term receivable represents the preferred share investment in TEC which consists of $1.0 billion of preferred shares purchased in 2001 as part of a capital restructuring, which hold a dividend rate of 7.9 per cent and $630.0 million in preferred shares received in 2003 in connection with the sale of Sheerness, which hold a dividend rate of 6.75 per cent. The aforementioned shares are redeemable at the option of the corporation. In June 2004, the corporation acquired an additional US$255.2 million ($312.7 million) preferred share investment in TEC which bears an annual interest rate of 5.8 per cent. This investment was funded through a demand loan with TAC for up to US$256.0 million which bears an annual interest rate of 5.8 per cent. These shares are redeemable at the option of the holder or issuer.*

17. COMMITMENTS

Commencing Jan. 1, 2001, generation assets became subject to long-term PPAs for the estimated remaining life of each plant or unit. These PPAs set a production requirement and availability target to be supplied by each plant or unit and the price at which each MWh will be supplied to the customer. The expiry dates for the corporation's PPAs, other than the Wabumun facility, range from 2013 to 2020. The PPA for the Wabamun facility expired at the end of 2003 and production was sold on the spot market in 2004.

Approximate future payments under operating leases and mining agreements are as follows:

	2005	2006	2007	2008	2009	2010 and thereafter	Total
Operating leases	$ 4.1	$ 3.3	$ 2.1	$ 1.1	$ 0.6	$ 0.2	$ 11.4
Mining agreements	8.6	8.2	8.3	4.8	4.9	67.4	102.2
Total contractual cash obligations	$ 12.7	$ 11.5	$ 10.4	$ 5.9	$ 5.5	$ 67.6	$ 113.6

18. OTHER CONTINGENCIES

On Dec. 16, 2002, the Canadian government ratified the Kyoto Protocol, which came into effect on Feb. 16, 2005. TransAlta Utilities is not able to estimate the full impact the Protocol will have on its operations, as the Canadian government has not yet established an implementation plan. However, the PPAs for TransAlta Utilities' coal-fired plants contain 'Change of Law' provisions that should provide an opportunity to recover compliance costs from the PPA customers.

The corporation is involved in various claims and legal actions arising from the normal course of business. The corporation does not expect that the outcome of these proceedings will have a material adverse effect on the corporation as a whole.

19. SUPPLEMENTAL CASH FLOW INFORMATION

	2004	2003
Depreciation and amortization expense per consolidated statements of earnings	**$ 80.0**	$ 91.2
Mining equipment depreciation, included in fuel expense	**27.5**	20.0
Accretion expense, included in depreciation and amortization expense and fuel expense	**(8.4)**	(8.3)
Other	**1.8**	2.9
Depreciation and amortization expense per consolidated statements of cash flows	**$ 100.9**	$ 105.8

20. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

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